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Summary of the Economic and Social Survey of Asia and the Pacific 2009

Summary

For the second time in a decade, the Asia-Pacific region has been hit by a financial crisis. This time, even though the crisis has its roots outside the region, the magnitude of the crisis, together with high levels of financial, trade and investment integration with the global economy, leaves no economy immune. The worst may be yet to come.

Consequently, the region continues to experience significant downward pressures on growth, with attendant social consequences that are still unfolding. The increasing spillover effects of the global financial crisis into the real sector, long-term challenges posed by climate change, and huge volatilities in food and fuel prices have all converged, compounding effects and dimming the prospect that the Millennium Development Goals will be attained by 2015.

In the present document, the Economic and Social Commission for Asia and the Pacific analyses how these threats to development have affected Asia and the Pacific and considers ways of addressing them. The fundamental changes that the convergence of the crises has brought to macroeconomic policies present a unique opportunity for the region to reorient economic growth towards a long-term development path that is more inclusive and sustainable. Governments will be compelled to re-enter the macroeconomic landscape — this time, however, in a more modernized form, that is to say, in partnership with their peoples. Together, they will play a key role in forming and framing the region's development path. Key concerted regional cooperation initiatives would bolster these actions.

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Introduction

1. Less than a year ago, the Asia-Pacific region had been coming to grips with the challenge of staggering price rises in staple foods and fuel, a crisis that was unfolding against the backdrop of a heightened global concern regarding climate change and the human toll taken by its associated environmental disasters. These events were soon overtaken when, for the second time in a decade, the region was hit by a financial crisis. This time, however, the crisis had its roots outside the region. In September 2008, the simmering financial crisis that had appeared to be confined to a few developed countries evolved into a global crisis, affecting individuals and communities far removed from the financial capitals of the world.

2. The occurrence and convergence of these crises will have compounding effects which will slow down the region's economic growth, and inevitably hinder the achievement of the Millennium Development Goals by 2015. In the present document, the Economic and Social Commission for Asia and the Pacific (ESCAP) analyses how these threats to development have affected Asia and the Pacific and considers ways of addressing them. A central idea is that the convergence of the crises also presents a unique opportunity for the region to reorient economic growth towards a long-term development path that is inclusive and sustainable. Governments, through a modernized form of governance and in partnership with their peoples, will need to play a key role in forming and framing that path. Key concerted regional cooperation initiatives will bolster these actions.

I. Outlook for the Asia-Pacific region: a synchronized downturn

3. The outlook for the economies of the Asia-Pacific region has darkened considerably since the last quarter of 2008, in the face of global economic setbacks and financial turbulence which have been greater than first anticipated. While the region is better prepared for currency and balance-of-payments crises than it was a decade ago, through having instituted wide-ranging reforms, improved current-account balances and built up a protective shield of foreign exchange reserves, the global slowdown arising from the crisis has exerted significant downward pressures on growth. The export sector is expected to be hardest hit by the double whammy of a severe shrinkage in trade financing and the curtailment of import demand in developed countries.

4. Furthermore, domestic private consumption has also been significantly impacted by wage pressures, job losses, a slowdown in remittances, and the wealth impact of asset value declines. Private investment is constrained because of the grim global and domestic sales outlook for companies as well as the international credit crunch. The worst may be yet to come, as the full extent of the global and regional downturns becomes evident and companies and individuals exhaust their immediate coping mechanisms. The region can thus not afford to be complacent.

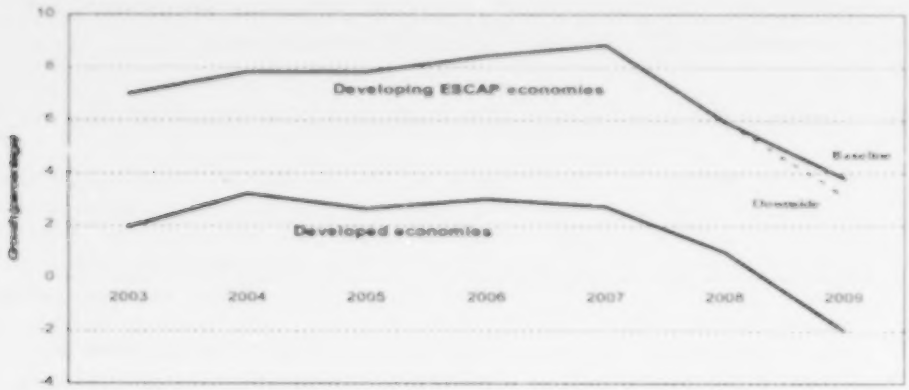
5. Economic prospects in the region will hinge on the extent to which policymakers are able to keep the engine of domestic demand churning. Notwithstanding this generally gloomy picture, fiscal stimulus should be able to render some support, particularly if domestic demand in Asia's largest emerging economies — China, India and Indonesia, among others — can be kept afloat.

Further intraregional trade flows may be triggered, adding some shock-absorbing effects to the region's economy.

6. In 2009, economic growth in developing economies in the region is expected to slow further to 3.8 per cent, down from an estimated 5.9 per cent in 2008 (figure I).[1] For the Asia-Pacific region as a whole, performance for the first half of 2008 showed resilience, as exports grew at 24 per cent, remaining strong and riding on the back of weakening currencies and relatively robust external demand. However, the full effect that the recession in developed countries will have on the region's exports will be felt in 2009. Notwithstanding these difficulties at the domestic level and the enormous social consequences that even moderate decreases in growth rates can bring, a comparison between these rates and those of the world's major developed economies highlights the region's relative strength and resilience with respect to the crisis. Comparatively high growth, coupled with the large aggregate size of the region's economy, will result in the Asia-Pacific region's being the locus of global growth in 2009.

Figure I

Real gross domestic product growth of selected developing ESCAP economies and developed economies, 2003-2009



Sources: National sources; International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., November 2008); Asian Development Bank, *Key Indicators for Asia and the Pacific 2008*, 39th ed. (Manila, 2008); data from the Interstate Statistical Committee of the Commonwealth of Independent States, accessed from www.cisstat.com, on 3 February 2009; and ESCAP estimates and forecasts. Figures for developed economies are taken from International Monetary Fund, *World Economic Outlook Update* (Washington, D.C., January 2009).

Note: Growth rates for 2008 are estimates; those for 2009 are forecasts.

[1] All gross domestic product growth rates in the present chapter are drawn from ESCAP estimates and forecasts, based on national sources as of 10 February 2009. Unless otherwise indicated, all other information in the present document is drawn from ESCAP, *Economic and Social Survey of Asia and the Pacific 2009: Addressing Triple Threats to Development* (United Nations publication, Sales No. E.09.II.F.11), forthcoming.

7. The possibility of a deeper economic setback in the United States of America, and consequently in the European Union (EU) and Japan, cannot be ruled out, given the highly fluid financial conditions and the uncertain impact of expansionary monetary policy and fiscal rescue programmes. The biggest prevailing downside risk for the regional forecast arises from the possibility that expansionary policies will not restore confidence among market agents and will fail to jump-start private investment and consumption. Under this scenario, there is an increase in the negative perception that Governments lack sufficient means to finance ever larger bailouts of the financial system and that exorbitant increases in public debt threaten future economic stability. A significant increase in bankruptcies and layoffs, job insecurity for those who are still employed, and further falls in asset prices, together with tighter policies on lending to households, would all form part of the downside scenario.

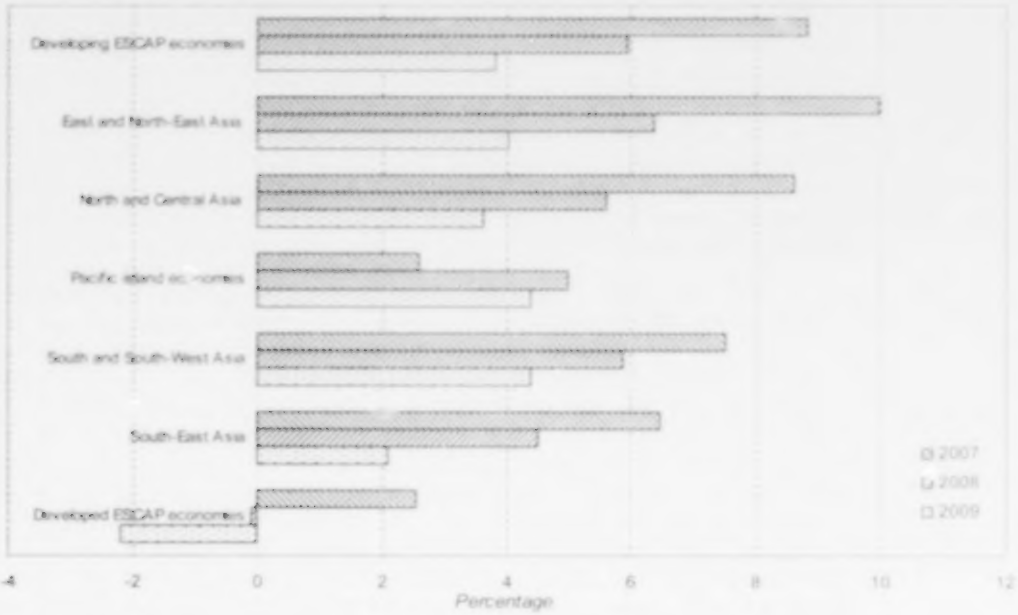
8. If there was a more pronounced setback in the United States, growth in that economy would fall by 3.0 per cent and economic growth in Japan and the euro zone would also dip into more negative territory. Under this scenario, Hong Kong, China; the Republic of Korea; Singapore; and Taiwan Province of China would be the most affected. Not only would they face slower export growth owing to the curtailment in global demand but, because they are more integrated with the financial sectors of the developed economies, the negative impact on their investment and consumption sectors would be greater. China would also face slower growth in absolute terms. However, given its high-growth path and the introduction of a strong fiscal stimulus plan towards the end of 2008, China is expected to achieve relatively robust growth even under the downside scenario. Other economies in the region would inevitably be hit by the severe downturn in the developed economies.

9. Overall, under a baseline scenario of -1.0 per cent growth in the United States, growth is forecast to continue to decline across all Asia-Pacific subregions in 2009, as shown in figure II. The subregion of East and North-East Asia is expected to continue to be one of the fastest growing, at 4.0 per cent in 2009, though its growth will be significantly slower than before the crisis. Export-dependent South-East Asian economies will grow the slowest, at 2.1 per cent in 2009. Economies dependent on energy exports will see some slowdown owing to lower fuel prices, with growth for North and Central Asia forecast to decrease to 3.6 per cent in 2009, down from 5.6 per cent in 2008. The deceleration rate for each country will depend on the extent to which domestic demand, stimulated by expansionary fiscal policy, can offset the setback in the export sector. It is thus expected that relatively slower deceleration will be experienced by South and South-West Asia, where economies are forecast to grow by 4.4 per cent, following estimated growth of 5.9 per cent in 2008.

II. Economic vulnerabilities

10. Looking forward, the economic crisis and its contagion effects have brought to the fore certain vulnerabilities in the region which need to be carefully monitored as the crisis unfolds. These pressure points are discussed below.

Figure II
Rates of economic growth of selected developing and developed ESCAP economies, 2007, 2008 and 2009



Sources: ESCAP, based on national sources; International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., November 2008); Asian Development Bank, *Key Indicators for Asia and the Pacific 2008* (Manila, 2008); Economist Intelligence Unit, *Country Reports* and *Country Forecasts*, various issues (London, 2008); data from the Interstate Statistical Committee of the Commonwealth of Independent States, accessed from www.cisstat.com, on 3 February 2009; and ESCAP estimates and forecasts.

A. Heightened exposure to mobile capital flows

11. The spark that has led to immediate macroeconomic difficulties for some economies of the region has been, once again, exposure to short-term portfolio capital. The significant and growing share of foreign portfolio capital in external financial liabilities has been a significant feature of many major developing economies across the region, including those most affected by recent equity and currency market declines (see figure III). At a time of generalized international risk aversion, using reserves to prevent the excessive currency depreciation that can result from the exit of short-term portfolio capital could reduce the amount of reserves available to cover external short-term debt repayments and current-account deficits. This is an ongoing concern for many countries.

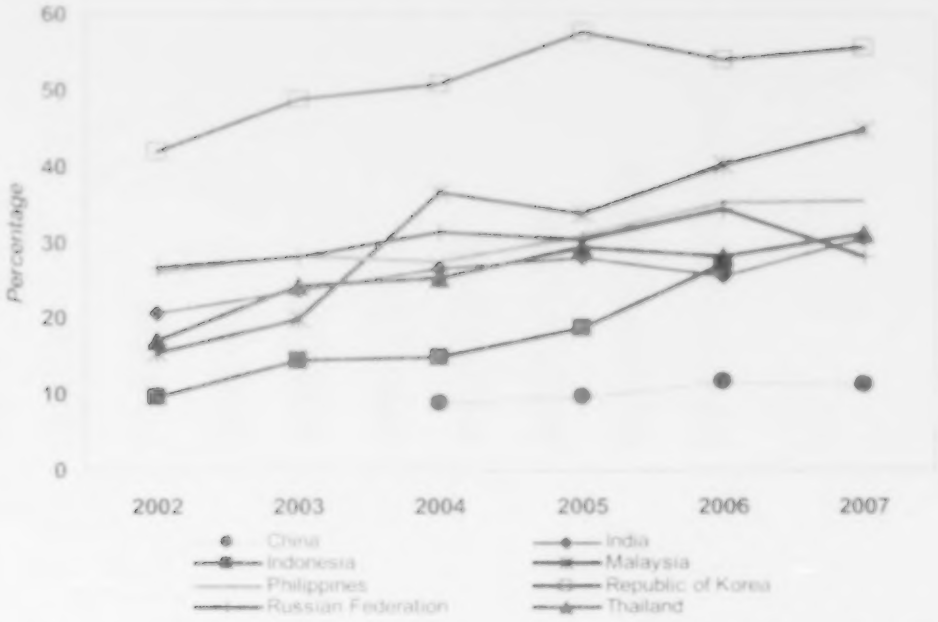
12. The reserves cover for portfolio investments has decreased substantially across much of the region over the past decade, and is now insufficient in many countries. At a time of unprecedented financial instability, in which flights to safety have low-threshold triggers, or in which liquidity constraints for financial institutions are prevalent, the situation can easily result in recalls for highly leveraged investors, and reserves may come under strain in a bid to defend currency values. Such

generalized outflows of capital may be further compounded by a similar exit of capital initiated by domestic residents, to the extent that residents are free to make portfolio investments abroad. It is clear that access to a greater pool of reserves than is normally adequate assumes an even more important role in reassuring investors and can, in turn, serve to reduce net capital outflows.

Figure III

Stock of foreign portfolio investment as a proportion of total external foreign liabilities, 2002-2007, selected ESCAP economies

(Percentage)



Source: International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., 2008).

Note: Figure derived from the international investment position in balance of payments of respective economies. The international investment position consists of portfolio investment, financial derivatives investment and other investment (short- and long-term bank credit, not included here).

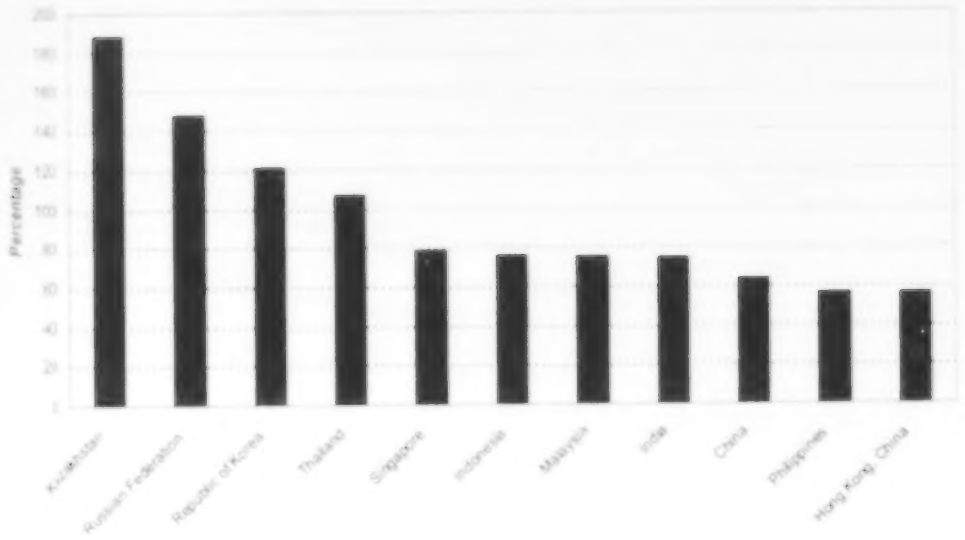
B. Banking sector vulnerabilities

13. The current crisis has also brought into focus banking sector concerns. Although most economies in the region possess adequate reserve cover for external short-term debt at the national level, banking sectors, in some cases, may run the risk of being overly dependent on foreign sources for their lending. It is important to ensure that the banking sector is healthy without Government assistance, as such assistance can create a generalized loss of confidence in the sector. Non-performing loans are currently below the international threshold of 8 per cent across major economies in the region, thus posing a less-immediate solvency risk and providing a buffer for the possible increases in such loans which may occur in coming months owing to the economic slowdown.

14. There are concerns, however, about liquidity shortages. Banking loans in some countries are notable for substantially exceeding domestic deposits (see figure IV), thus requiring banks to rely on significant wholesale funding. To the degree that such funding comes from external sources and is made up of short-term loans, the global credit crunch may result in banks' coming under stress in funding their activities. Currency mismatches in such funding expose banks to exchange-rate risks as well, while maturity mismatches can lead to rollover and interest rate risks.

Figure IV

Loan-to-deposit ratio of selected developing Asian economies (latest available data)



Sources: ESCAP staff estimation based on CEIC data (China; Hong Kong, China; India; Indonesia; Philippines; and Singapore); CEIC data (Malaysia and Thailand); Asian Development Bank (Kazakhstan); and ESCAP staff calculation based on statistics from the Central Bank of the Russian Federation (Russian Federation).

C. Managing currency volatility

15. Exchange rates in the region may remain under pressure for some time, as the global recession will mute the contributions of portfolio flows, inflows of foreign direct investment (FDI) and export earnings. Furthermore, in a climate of sluggish exports and intracountry variations in exchange-rate movements, there is the risk of a cycle of competitive devaluations between countries in the region. Regional economies will also be under pressure to devalue against the currencies of major trading partners, in line with their neighbours, in order to maintain the competitiveness of their exports. Such extraregional and intraregional devaluations, if conducted in an uncoordinated manner, lead to unnecessary losses in national export earnings, increased debt-servicing and repayment costs and heightened uncertainty.

D. Increased trade dependence

16. Increased trade dependence has characterized economic growth in the region. Merchandise exports, as a share of gross domestic product (GDP) in Asian developing countries, increased by almost 8 percentage points between 1995 and 2007, reaching 37.5 per cent. What was once the engine of growth in the region has now become a heightened source of vulnerability which will reduce the extent to which the financial crisis can be mitigated. Although ESCAP developing economies, as a group, are decreasing the total share of exports that are sent to United States and Japanese markets and reorienting towards the markets of China and India, exports are growing faster than GDP. This means that developing countries have maintained their dependence on exports to the United States, the European Union and Japan as a percentage of GDP. In fact, shares of exports to these countries as a percentage of GDP are unchanged or increasing. Furthermore, intraregional trade is based heavily on parts and components for the manufacturing sector which, in turn, are linked to demand for final consumer products in developed countries. The countries, areas and companies that are most directly linked, through production networks, to the markets of the United States and the European Union could be the most vulnerable to the recession in those markets. Hong Kong, China; Malaysia; Singapore; and Thailand would be among the economies most affected. The recession in developed countries will therefore work its way back to the region through the channel of trade and investments.

17. Another concern is that, in a climate of severe economic slowdown, some countries, in an effort to shield ailing domestic industries from competitive imports, may be tempted to increase protectionism through increased tariffs and other forms of protectionism.

III. Commodity price volatilities

18. After decreasing for two decades, fuel and food prices had started to increase between 2001 and 2008, spiking in the first half of 2008 (see figure V). The price of rice, the region's staple and the main source of sustenance for 950 million people living in absolute poverty, increased the fastest — 150 per cent in less than three months. As the financial crisis started to intensify, the astounding increases of the first six months of 2008 were followed by sharp corrections downwards for fuel and food. This dramatic volatility in the 2008 prices of oil and non-oil primary commodities, which paralleled the financial crisis closely, made it even clearer that commodity and financial markets were closely interlinked, and that the crises were converging and having compounding effects.

19. The difficulties in the United States housing market surfaced in 2006, with the levelling of house prices, a sharp increase in foreclosures, and increases in interest rates, which eventually led to the credit crunch in late 2007; that same period was also characterized by a rapid increase in trading in commodity futures. The combination led to an overshooting of commodity prices. However, with mounting problems in global financial markets and growth projections turning sour, speculative capital rapidly exited commodity markets, leading to sharp and sustained falls in futures prices. That was followed by a flight for safety to United States Treasury bonds. Hence, as commodity prices fell in late 2008, the United States dollar strengthened. Looking forward, a key concern is that the massive

liquidity created for bailouts may find its way into commodity futures once again, causing another sharp increase in commodity prices, for which the region may discover that it is unprepared.

Figure V
Food price index and Brent crude oil price, 1980-2008

Source: ESCAP, based on data from the International Monetary Fund (available at www.imf.org/external/nap/res/commod/externaldata.csv).

A. Long-term threats to food security

20. Long-term disequilibria between sluggish supply responses and increases in demand fed the volatility in food and fuel prices. The world stocks of wheat, maize and rice, measured in consumption days, have dropped to the lowest levels in 30 years. The soaring price of oil also played a critical role in food price increases by: (a) raising the costs of agricultural inputs, which made it that much more expensive to apply fertilizers, operate agricultural machinery, and transport food to urban areas and across countries; and (b) stimulating the production of crops for the biofuel industry, triggering competition and price increases in land, water and other resources needed for the production of food crops. The impact of high oil prices on agriculture was also magnified because agriculture has become more energy-intensive in the past decade.

B. Effects on agriculture

21. The instability of agricultural prices over the past few decades has been an important factor in the decline of investment in agriculture; the events of recent months will further exacerbate the perception of such investments as high-risk. As a consequence of the prolonged period of declining real prices which ended only recently, incentives for investment in agriculture declined, causing the average annual rate of yield growth to drop to 1.2 per cent between 1990 and 2005. Similarly, the global average annual rate of growth in land area also dropped significantly, from 0.7 per cent between 1970 and 1990 down to 0.2 per cent between 1990 and 2005. Fast economic growth and urbanization had created incentives for rural workers to migrate to the cities in search of better earning opportunities, and in the process of urban development, agricultural lands were converted to alternative uses.

22. Incentives for farmers to keep up production had been particularly low in the early 2000s, following a dramatic drop in cereal prices of more than 50 per cent between May 1996 and August 2000. As a result, the world production of maize, rice, wheat and coarse grains lagged significantly behind consumption for four or more years in the early 2000s. This extended episode, which resulted in the large drop in cereal stocks, was unprecedented in recent memory. In the past 30 years, production of maize and wheat had occasionally dropped substantially below consumption, usually as the result of major crop failures in important production areas, but recovery was quick.

C. Effects on the poor

23. The high food prices that hit the world in mid-2007 brought the issue of food security to the forefront of global attention, including in the Asia-Pacific region. Food insecurity has been a major development challenge in many countries of the region for a long time. It is estimated that the region has some 950 million people living below the revised poverty line. Another 583 million people are undernourished, a direct result of food insecurity; 46 per cent of all children in South Asia and 29 per cent of children in South-East Asia are underweight. It is feared that the global financial crisis will exacerbate this situation and push many more people into poverty if appropriate measures are not taken.

24. A major concern about food inflation is its adverse impact on poor households that are net buyers of food. An additional 41 million people in the Asia-Pacific region were pushed into undernourishment in 2007. Poor rural households with no land or with small landholdings, as well as those who do not use fertilizers or pesticides, are among the most severely affected by the increase in food prices. In particular, poor female-headed households, both rural and urban, suffer because food products represent a larger proportion of their expenses and because they are more likely to face constraints on accessing land and credit.

25. Along with the serious short-term consequences of food price increases, of great concern is their long-term impact on the ability of the poor to recover from the shock and eventually exit poverty. While richer households may cope with the price shock by cutting non-essential expenditures or drawing on their savings, these options may not be available to the poorest, who may be forced to further deplete

their meagre asset base, or cut essential expenditures, on education, for example. This, and the longer-term impact of inadequate food consumption, would translate into lower productivity and income-generation potential in the medium to long run.

IV. Climate change: disproportionate costs for the region

26. In the Asia-Pacific region, the impact of climate change is likely to be severe, with water and the agricultural sector facing the greatest threats. Agricultural productivity in the region is projected to decrease by 5-30 per cent by 2050, as compared with the levels of 1990. This would lead to drastic consequences in terms of poverty and hunger, particularly for women, as they represent a higher share of labour in agriculture. Increased water stress is likely to hit 185 million-1 billion people in Asia and the Pacific, increasing the risk of health hazards. Women and girls would bear the major brunt, as they will have to spend even more of their time fetching water, with adverse effects on income-generation and education. Another concern is rising sea levels, which are a major threat to coastal areas and many Pacific island countries. A combination of increasing temperatures and rises in the sea level can change patterns of coastal circulation, which in turn affect coastal erosion, freshwater supply and fish stocks.

Socio-economic impacts of climate change

27. The Asia-Pacific region is likely to experience disproportionately large and adverse socio-economic consequences of climate change, owing to the locational disadvantages of many countries and a weaker resilience with respect to additional heat in lower latitudes. People with lower income will be most adversely affected, as they depend heavily on climate-sensitive activities, such as agriculture, forestry and fishing. They are more vulnerable, as they lack resources and options for taking mitigation and adaptation measures. Similarly, least developed countries in Asia and the Pacific are likely to be more vulnerable.

28. The impact of climate change on agriculture in rural areas, where the majority of the region's poor reside, could seriously affect the livelihood of millions, putting them at risk of hunger and malnutrition. Owing to their low elevation, the atolls and coral islands of the Pacific are expected to be among the first areas to experience the consequences of climate change; their denizens will be forced to adapt or abandon their habitats. Populations have increased substantially in most Pacific island countries, increasing the number of people living near coastal areas. The expected effects of climate change would result in socio-economic costs beyond the capacity of many Pacific island countries, ultimately threatening their existence.

29. If climate change increases the frequency and intensity of natural disasters, Asia and the Pacific may suffer far more than any other region, given its vulnerability to environmental and economic shocks. Over the last century, 91 per cent of deaths from natural disasters occurred in Asia and the Pacific. The death and destruction inflicted by cyclone Nargis in Myanmar demonstrated the vulnerability of countries in the region, which adds another burden to the ongoing development challenges, making them all the more daunting.

30. The assessment of economic damage caused by climate change through natural disasters is relatively straightforward. However, social damage, in terms of loss of human life, injury and adverse psychological impacts, is hard to quantify and is, for many, an indescribable source of hardship.

V. Convergence of the crises: reorienting the development path of the region

31. Given the convergence of the crises and their compounding effects, responses need to be built around rebalancing: between economic, social and environmental systems, and between Governments and their partners. Putting these solutions to work is a process that reaches beyond market dynamics: it spans continents, linking people and societies to each other, and stretches across time, linking generations. How can this be achieved? Before this question can be answered, the nature of the linkages across the crises must be examined. It is in this context that the full significance of applying the principles of sustainability and inclusiveness throughout the development process can be observed.

A. Commonalities and their compounding effects

32. One characteristic that is common to these three threats is their global reach: no country, and very few individuals, are left unaffected. Crises no longer fit into simplistic developed-developing-country classifications. Disaster can strike financial capitals with the same ferocity as that experienced by emerging markets. Hurricane Katrina and cyclone Nargis tore apart communities in countries at opposite ends of the development spectrum. What is certain is that the poor, regardless of their location and the nature of the crisis that hits, are impacted more severely and take longer to recover. They are also those least responsible for causing the crisis. A second commonality is that all three crises are long-term, although each hits suddenly and forcefully. The current global financial crisis has its roots in long-run macroeconomic and financial vulnerabilities which have been building up over the decades. The price increases in crude oil and food commodities between 2002 and mid-2008 reflect underlying long-run trends in demand and supply conditions. And the threats posed by climate change to food production, water resources and livelihoods in coastal areas are associated with a long process of intensification of industrial production and human activity.

33. Ultimately, however, imbalances are the root cause of all the crises. The financial crisis is associated with an imbalance between savings and expenditures, both within countries and across countries. Food and fuel price increases are associated with fast-rising demand for crude oil and food commodities, especially cereals, met by a sluggish supply response, which caused inventories to drop. An imbalance in access to water, sanitation, energy, health and education is associated with endemic poverty which perpetuates environmental degradation over generations. Furthermore, there is a tendency for imbalances to grow. Economic wealth is increasingly concentrated in the hands of fewer people, thus superimposing wider circles of imbalances which will compound and perpetuate the crises. When imbalances in the financial markets were added to those in energy and

food markets, commodity prices soared further, compromising both economic growth and the goal of eliminating poverty and hunger.

34. The stresses are common to more than one crisis, and the compounding effects must be taken into account when devising policy responses. Mitigating climate change and reducing the chance of future episodes of soaring crude oil prices share commonalities, and those synergies can be exploited through the promotion of energy efficiency and the use of renewable energy. But this is not enough. An overemphasis on the need to attain energy security could worsen food security and climate change challenges, if biofuel cultivation uses arable land that was meant for the cultivation of food crops, or if it contributes to deforestation.

35. Yet another key concern in respect of the triple crisis involves the increasing fiscal deficits and public debt. With the list of distressed institutions and people growing everyday — be they ailing banks, strategic industries hurt by the downturn and price volatilities, farmers unprepared for the collapse in commodity prices, urban poor struggling with higher food prices or the increasing ranks of unemployed, to mention but a few of the victims — Governments may come under severe pressure to spend their funds on immediate emergencies and maintaining social stability and order. They may be hesitant to dedicate scarce resources to long-term objectives, such as climate change, where the returns are not immediately obvious. Furthermore, as economic growth continues to decelerate, declining tax revenues will give Governments even less fiscal space. Under this scenario, if the perception grows, particularly in developed markets, that fiscal stimulus is failing to restore confidence among market agents and that Governments may lack sufficient means to finance ever larger bailouts of the financial system, they will shift to future generations the costs of dealing with long-run challenges.

36. Similarly, it is clear that, given all of the above, aid budgets could come under greater pressure. This would particularly affect low-income countries, which are dependent on official development assistance (ODA) not only for their poverty alleviation strategies and long-term development but also as a cushion against external shocks. Least developed countries that are experiencing large and growing fiscal deficits will be particularly vulnerable.

B. Reorienting the role of Government

37. Any reorientation of policy must begin with Governments — with their institutions and policies and how they collaborate with each other regionally and in the multilateral arena to support long-term visions and keep systems stable and in equilibrium. The sheer magnitude of the financial crisis, combined with the food and environmental crises, has changed the macroeconomic landscape in fundamental ways. Calibrating the use of financial instruments for economic growth, balancing the use of energy for sustainable growth, and sharing economic wealth for inclusive development will feature much more prominently than they did in the past, when allocative decisions were left increasingly to market mechanisms and their inherent tendency to self-correct and clear imbalances. The risks and costs inherent in market failures proved to be too brutal, as it became clear that the role of Government had been neglected for too long. Governments are now being called upon to re-enter the economic landscape, although it would be a mistake to return to the forms of governance of past decades, in which Governments owned, regulated

and managed large swathes of productive resources. Rather, the re-entry of Government should evolve around modern forms of economic governance and societal organization. Principles and practices that could guide this are outlined below.

38. First, it is important to recognize that the times are abnormal and that the crisis calls for policy actions that are commensurate with the scale of the problem. Government's re-entry into the economy should involve public spending of a magnitude much larger than in the past, with fiscal deficits that could rise above what sound macroeconomic management would prescribe under normal circumstances. With the huge drop in external demand for Asian exports, and declining domestic demand, the region will have to rely on public spending to stave off the worst of the crisis. Public spending thus has a key macroeconomic purpose. It should also be expedient, so that the depth of the downturn is contained. With about $4 trillion in foreign exchange reserves, large current-account surpluses, low inflation and fiscal deficits that have been substantially reduced as compared with those during the 1997 crisis (see table), many major Asian countries are well placed to expand public spending.

39. Second, perhaps even more important than the size of investments is how Governments will spend. Public expenditure should be carefully targeted. Fiscal resources are expensive and today's increases in budget deficits will eventually need to be cut. Thus, ensuring that current fiscal expenditures have the highest social rates of return is crucial in order for Governments to be able to make sound investment decisions. Even though the composition of the stimulus packages will depend on country-specific situations, particularly a country's level of development, overall, the crisis affords Governments an opportunity to look forward and plan for the long term. The importance of investing in the region's richest resource — its peoples, and all the diversity, culture and values that they represent — cannot be overstated. Spending, not only on social infrastructure (hospitals, schools, housing and sanitation) but also on improving the delivery of education and health systems, is key in determining the nature and quality of future economic growth and development in the region.

40. Related to this is the need to expand social protection systems. Over 80 per cent of the region's population lack access to social protection systems of any form, forcing millions to use harmful coping mechanisms, such as reducing meals, eating less nutritiously, taking children out of school, selling livestock and other assets, and borrowing money to feed their families. Furthermore, although the inflation rates of domestic food prices are gradually coming down across the Asia-Pacific region, there is no guarantee that another episode of fast-rising food prices will not occur when the global economy resumes growth. It is important to provide all vulnerable individuals with minimum grants to support their food security, especially in countries that are unable to move progressively towards universal coverage of the population. Likewise, social issues must be sufficiently addressed in the policies and programmes to mitigate the impacts of climate change and natural disasters. Such an approach recognizes the significance of human development and well-being in the overall development process.

Budget balances in selected economies in the ESCAP region, 1997, 1998, 2007 and 2008

(Percentage of gross domestic product)

	1997	*1998*	*2007*	*2008*
Developing ESCAP economies				
East and North-East Asia				
China	-1.9	-2.4	0.7	0.4
Hong Kong, China	6.4	-1.8	7.2	-1.2
Mongolia	-9.1	-14.3	2.9	-2.5
Republic of Korea	-1.4	-3.9	3.8	1.5
North and Central Asia				
Armenia	-1.7	-3.8	-0.7	-0.8
Azerbaijan	-2.4	-1.8	-0.2	-1.6
Georgia	-7.7	-7.6	0.8	..
Kazakhstan	-3.7	-3.9	-1.7	-2.2
Kyrgyzstan	-5.2	-3.0	0.1	-0.7
Russian Federation	-6.4	-4.8	5.4	5.5
Tajikistan	-4.1	-2.7	1.7	-0.3
Turkmenistan	-0.2	-2.6	0.4	-0.3
Uzbekistan	-2.4	-2.0	..	..
Pacific islands				
Cook Islands	1.1	-2.5	3.6	..
Fiji	-6.5	5.0	-1.3	-1.5
Kiribati	56.0	51.0	..	..
Papua New Guinea	0.2	-1.8	2.5	1.0
Samoa	2.2	2.0	1.1	-0.3
Solomon Islands	-3.6	3.0	-1.1	1.3
Tonga	-4.8	-2.4	1.5	-1.0
Tuvalu	-31.8	19.1	-14.3	..
Vanuatu	-0.5	-9.4	-0.3	1.0
South and South-West Asia				
Bangladesh	-3.7	-3.4	-3.7	-4.8
Bhutan	-2.3	0.9	0.5	..
India	-4.8	-5.1	-3.1	-4.5
Iran (Islamic Republic of)	-1.0	-2.2	-3.4	-5.4
Maldives	-1.4	-1.9	-7.1	-9.7
Nepal	-4.8	-5.5	-4.1	-4.0
Pakistan	-6.4	-7.6	-4.3	-7.4
Sri Lanka	-7.9	-8.9	-7.7	-7.0
Turkey	-6.0	-6.2	-1.6	-1.8

	1997	1998	2007	2008
South-East Asia				
Cambodia	-3.7	-5.4	-2.8	-2.2
Indonesia	0.5	-1.7	-1.3	-1.2
Lao People's Democratic Republic	-5.2	-6.6	-3.1	-3.0
Malaysia	2.4	-1.8	-3.2	-5.1
Myanmar	-0.9	-5.7	..	..
Philippines	0.1	-1.9	-0.2	-0.8
Singapore	3.4	2.5	3.4	0.9
Thailand	-1.5	-2.8	-2.4	-1.4
Timor-Leste	..	..	297.0	352.0
Viet Nam	-4.1	-2.5	-4.9	-4.1
Developed ESCAP countries				
Australia	0.1	0.3	1.6	1.8
Japan	-4.0	-5.6	-3.2	-3.4
New Zealand	2.2	2.1	2.6	1.4

Sources: ESCAP, based on national sources; Asian Development Bank, *Key Indicators for Asia and the Pacific 2008* (Manila, 2008); International Monetary Fund, World Economic Outlook database (Washington, D.C., October 2008); International Monetary Fund Article IV consultations; and ESCAP estimates.

Note: Data for 2008 are estimates.

Data for Mongolia, the Lao People's Democratic Republic, Myanmar (since 1998), the Philippines, Timor-Leste, Viet Nam, Bhutan, Maldives, Nepal, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, the Russian Federation, Tajikistan, Turkmenistan, Cook Islands, Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu include grants.

41. Forward planning also requires Governments to start making provisions for an ageing society. The population of Asia is ageing fast, with 17 per cent of its developing-country population expected to be over 65 years of age by 2025, as compared with 6 per cent today. This increase is occurring twice as fast as that of developed countries. Of even more concern is the narrow coverage of social pensions, and poverty rates among older people that are about double that of the population as a whole, as a result of which many are denied the right to dignity and security. This situation also prevents older persons from contributing to society as repositories of experience, wisdom and heritage, and as agents of economic activity. Investing in social pensions would have significant multiplier effects that are immediate; for example, those who received a pension could take better care of children in their charge. This would make development more inclusive and sustainable, while transforming societies into more cohesive and stable wholes.

42. In the current debate about fiscal stimulus packages, some countries have opted for providing tax cuts or transfers to boost private consumption. Such policies are viewed as acting faster than policies that support public expenditure on physical or social infrastructure. However, this may not be the case in the present circumstances. Given the overall pessimism and uncertainty, many households may opt to save, rather than spend, most of these benefits. Also, if the downturn is

prolonged, a longer-lasting public spending commitment may be more valuable than a fast-acting one. Tax reductions, when utilized, should target the poorest members of society. This not only helps meet social goals, it also ensures greater pass-through of tax reductions to national consumption and aggregate growth, because the poor are most likely to spend any extra income.

43. Governments should plan for and support the development of cutting-edge technological innovations that have yet to reach their peak. Such a policy should not be restricted to the more advanced countries of the region, as there are numerous examples of less well-off countries successfully investing in such innovations. The development of clean technologies for mitigating climate change effects and environmental degradation will depend crucially on such Government support. The current economic crisis should not be allowed to derail action on climate change, because inaction today will prove costly in the future, when trends may be irreversible. In some countries, costs could rise above 20 per cent of GDP. Clean technologies provide many leapfrogging opportunities that stretch beyond the environmental sphere. Innovation feeds on itself, and powerful applications of new technologies will emerge in informatics, biotechnology, stem cell research and robotic engineering, enabling the region to transform itself into a global source of renewal and growth.

44. Investment in infrastructure is another important component of a forward-looking planning approach, particularly for countries of the ESCAP region that are in the early stages of infrastructure development and rehabilitation, where social rates of return are likely to be very high. In this respect, countries may wish to consider: (a) continuing and perhaps even intensifying ongoing initiatives; (b) speeding up the implementation of projects that have largely been through the evaluation process; (c) streamlining the processes in the project cycle; and (d) improving public confidence in infrastructure development by increasing transparency.

C. Government as the people's partner

45. Evolving a modern form of governance will also entail looking beyond Government to other stakeholders and the alliances that Government forms as a partner of its people. A key player in this process is the business sector, because business creates jobs, supports aggregate demand and creates wealth. The convergence of the crises has shown that business increasingly shares with Government common aspirations in respect of achieving a more inclusive and sustainable path of development. This opens up the possibility of new alliances in which it would be possible for businesses to be socially and environmentally responsible as well as profitable. Civil society organizations are also key partners in the new alliances that are forming. In addition to monitoring and tracking Government performance, they add transparency to the process. Evolving a clearer system of accountability for civil society organizations would add further legitimacy to their role.

VI. Policy recommendations: from crisis resilience to crisis resistance

46. The convergence of the crises has changed the macroeconomic landscape in fundamental ways; Government will be re-entering the economic sphere in a role that forms and frames the region's development path. The triple threat to development calls for a set of policy actions that will address specific concerns, while reorienting the development paradigm. Members and associate members may wish to consider the recommendations proposed and provide further guidance to the secretariat.

A. Finance and macroeconomic reform

47. The reform of the global economic architecture is expected to remain at the top of the international policy agenda. In particular, the need to reform the international financial system and provide better safeguards to prevent a recurrence of the present crisis is expected to take centre stage. The Asia-Pacific region, commensurate with its rising contribution to global economic prosperity, could expect to have an influential voice in shaping a more inclusive multilateral architecture. The time to act is now; through more effective use of existing regional platforms, members and associate members of ESCAP could debate policy options, sharpen their focus and build political consensus around the multilateral reforms needed.

48. At the regional level, a largely neglected debate concerns the formulation of effective and coordinated macroeconomic policies to move the region from crisis resilience to crisis resistance. Coordination to increase the effectiveness of expansionary fiscal and monetary policies assumes particular importance in this crisis. Exchange-rate coordination and the closely related challenge of managing vulnerability to reversals in short-term capital flows would both benefit from the establishment of more coordinated and durable regional arrangements.

49. Of equal concern for the Asia-Pacific region is the need to establish a regional contingency plan for responding quickly to the liquidity and capitalization problems of domestic banks. However, this would require the accelerated establishment of a regional surveillance system that focuses on emerging risks. Consequently, there is a pressing requirement to analyse the large information gaps that exist in assessing systemic financial risk. As a first step, a database of financial indicators has been set up by ESCAP to track the performance of those indicators.

50. The global financial crisis has put enormous pressure on Asia-Pacific exporters to increase competitiveness in order to exploit rapidly declining export opportunities; but it has also raised protectionist pressures, as economies scramble to support ailing domestic industries. This calls for a strengthening of the multilateral trading system, including a conclusion of the Doha Round of negotiations, in accordance with its development mandate, as this system offers the most stable and transparent environment for conducting global and regional trade.

51. The curtailment of trade has been exacerbated by the lack of trade credit. Somewhat anomalously, given the high importance of trade in Asia and the Pacific, this is the only region that does not have its own regional institution specifically dedicated to export credit and export credit guarantees. A regional trade-financing

facility would facilitate risk-pooling across countries and scale economies. It would also have more credibility than isolated national initiatives, thus offering countries, particularly those with special needs, greater access to international finance. There should be an accelerated process of analysis and dialogue in order to establish such a facility.

B. Dealing with food/fuel price volatilities

52. The reasons for the soaring food and fuel prices up to June 2008 are complex and involve some novel aspects, such as the closer links among food, fuel and capital markets. As noted above, coordinated monetary, financial and fiscal policies aimed at avoiding excessive liquidity in international financial markets can be helpful in preparing for and/or reducing the risks involved in excess volatility in fuel and food commodity prices, and in curbing excessive speculation. This should be a key item in the agenda for the reform of the international financial architecture, with major commodity exporters in the region playing a leading role in the discussions.

53. Related to this is the need to expand social protection systems. With over 80 per cent of the region's population lacking access to social protection systems of any form, the region should prepare for another episode of fast-rising food prices when the global economy resumes growth. It is important to provide all vulnerable individuals with minimum grants to support their food security, especially in countries that are unable to move progressively towards universal coverage of the population.

54. Given the pressure of the biofuel industry on water, land and other resources needed for food production, and the consequent impact on food prices, policies oriented towards this industry should be carefully re-examined. As a result of such re-examination, a global code of conduct could be proposed, outlining principles and practices that would enhance positive linkages among biofuel production, food security and sustainable development. A coalition of like-minded Governments, businesses, farmers and consumer associations from this region could take the lead.[2]

C. Dealing with climate change challenges now

55. Appropriate short- and long-term economic and social policies to promote the mitigation of and adaptation to climate change must be adopted at the national, regional and global levels. Main mitigation measures include: (a) promoting eco-efficiency; (b) encouraging carbon-neutral lifestyles; (c) reversing deforestation; and (d) managing waste more efficiently. Adaptation measures include:

[2] The food security summit held in Rome in June 2008 recommended forging an international consensus on the following five areas: (a) safeguard mechanisms for food security; (b) sustainability principles; (c) research and development, knowledge exchange and capacity-building; (d) trade measures and financing options; and (e) methodologies for measuring and monitoring biofuel impacts. See Food and Agriculture Organization of the United Nations, "Bioenergy, food security and sustainability: towards an international framework" (HLC/08/INF/3 of April 2008), document prepared for the High-level Conference on World Food Security: the Challenges of Climate Change and Bioenergy, Rome, 3-5 June 2008 (available at ftp://ftp.fao.org/docrep/fao/meeting/013/k2498e.pdf).

(a) investments in research and development in food and agriculture; (b) coastal zone management; and (c) designing appropriate interventions for social protection. The availability of financing and climate-friendly technology would be crucial in achieving these objectives. Regional cooperation will also play an important role.

56. There is a close relationship between measures that address the fuel crisis and those that address climate change. Coordinated policies are required to ensure energy security and counter the long-term threat of climate change. Securing energy supplies and speeding up the transition to a low-carbon energy system both call for radical action by Governments, at national and local levels and through participation in coordinated international mechanisms. Households, businesses and motorists will have to change the way they use energy, while energy suppliers will need to invest in developing and commercializing low-carbon technologies. To make this happen, Governments have to put in place appropriate financial incentives and regulatory frameworks that support both energy-security and climate-policy goals in an integrated way.

VII. Towards an Asia-Pacific framework for inclusive and sustainable growth and development

57. The complex linkages among the crises underline the need for a reorientation of the development paradigm towards a more inclusive and sustainable path of economic growth and development. This will require a more directive role for Government in the economy. The role of Government as planner (former and framer) of development will need to be reprioritized, as will the need for a regional collective effort to guide, support and enhance synergies. Building on previous work of the ESCAP secretariat, notably, the Bali outcome document,[3] it is proposed that a meeting be convened by ESCAP, in partnership with interested stakeholders, where high-level officials would work on a framework for guiding the region's policymakers towards a common development paradigm.

58. Some key elements of an Asia-Pacific framework for inclusive and sustainable development are:

(a) *Comprehensiveness*. Partial sustainability frameworks can create potential inconsistencies which make the pursuit of one goal detrimental to the pursuit of another. To avoid this problem, all dimensions of sustainability should be covered under the same framework;

(b) *Sufficient details to increase pragmatic relevance*. While agreeing on general goals is a step forward, the urgency with which measures must be taken requires the framework to include references to specific policy actions and time frames;

(c) *Coordinated fiscal and monetary policy*. As recessionary conditions spread from industrialized to developing countries, coordinated fiscal and monetary

[3] Adopted at the High-level Regional Policy Dialogue on the Food-Fuel Crisis and Climate Change: Reshaping the Development Agenda, Bali, Indonesia, 9 and 10 December 2008 (available at www.unescap.org/LDCCU/Meetings/HighLevel-RPD-food-fuel-crisis). The Dialogue was jointly organized by ESCAP and the Government of Indonesia.

responses would have greater credibility, help shore up confidence, and enhance region-wide and global multiplier effects;

(d) *Coordinated mechanisms for cross-country technical cooperation, with special emphasis on supporting least developed countries.* The challenges of implementing a comprehensive reform agenda to foster sustainable growth are many, both because of the novelty of some of its components and because it requires building capacity and fostering technical knowledge across Government agencies. However, advanced countries already have much expertise in these areas; thus, North-South technical cooperation should be fostered. It is also important to consider South-South cooperation towards contributing to the diffusion of technical expertise in the region.